

April 28, 2003

The Honorable Michael M. Reyna  
Chairman of the Board and  
Chief Executive Officer  
Farm Credit Administration  
McLean, Virginia 22102

Dear Mr. Reyna:

Enclosed is the semiannual report on the activities of the Farm Credit Administration's Office of Inspector General for the period from October 1, 2002 through March 31, 2003. We are filing this report in accordance with the Inspector General Act of 1978, as amended. This is the twenty-eighth report since creation of the office on January 22, 1989. Section 5(b) of the Act requires that you send this report to the appropriate Congressional committees and subcommittees within 30 days after the date of this transmittal, with management's report on the status of audit recommendations.

With a full complement of Board members, we look forward to unprecedented advancement in governance of the Farm Credit Administration and its leadership to the Farm Credit System, continually aiming to improve quality of life in rural America.

Respectfully,

A handwritten signature in black ink, appearing to read "Stephen G. Smith". The signature is fluid and cursive, with a large initial "S" and a long, sweeping underline.

Stephen G. Smith  
Inspector General

Enclosure



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## **EXECUTIVE SUMMARY**

This semiannual report to the Congress summarizes the activities and accomplishments of the Farm Credit Administration (FCA or agency), Office of Inspector General (OIG) and covers the period October 1, 2002 through March 31, 2003. Our efforts were directed toward performing audits, inspections, and evaluations of the FCA programs and operations, conducting several investigations, and providing technical assistance and advice on FCA programs.

The FCA Board is at full strength. Moreover, the Board members are engaged in healthy discussions about regulatory and enforcement issues facing the FCA. The Board members are embracing a collegial relationship that is vital to the organization. We believe that prior work we performed on governance will help serve as a building block for a strong Board.

The Board is reaching out to the public to gain their views on regulatory approach, in part, due to the comments from the survey on Regulatory Development that was conducted by OIG during the last reporting period. The Board is making an effort to reach out to the public and Congress to gain broad input into carrying out the agency's mission. An Ombudsman has been appointed to further enhance the public outreach effort.

Under the Chairman's leadership, the FCA has made significant strides towards resolving agreed upon management actions. The focus on progress towards resolving agreed upon actions and recommendations at monthly Board briefings has resulted in corrective action on several long-standing issues and quick resolution of new agreed upon actions.

The OIG advised managers on multiple issues that came to our attention. This advice encourages managers to take proactive actions. For example, we encouraged agency managers to adopt "change management" practices in reviewing operations to improve effectiveness. We also identified improvements needed in several agency policies. OIG input contributed to improved efficiency and controls in areas such as emergency planning.

## **BACKGROUND**

The FCA is an independent Federal agency of the United States government responsible for the regulation, examination and supervision of institutions chartered under the Farm Credit Act of 1971, as amended (Farm Credit Act). FCA is a nonappropriated agency with a fiscal year (FY) 2003 budget of \$38,033,000 for administrative costs. The FY 2003 budget for the OIG was \$829,601. FCA is a “designated Federal entity” within the meaning of the Inspector General Act of 1978, as amended.

FCA currently has 280 employees, about half of which are examiners located at five field offices. Also included in the agency positions are five approved positions for the OIG. Appendix 2 displays the current organizational structure of FCA and Appendix 3 displays the OIG within that structure.

## **MANAGEMENT CHALLENGES**

This section of the report outlines major challenges confronting the agency as it works to fulfill its mission. These challenges fall into two general categories. First are the challenges related to the FCA’s core mission of ensuring a dependable supply of credit to agriculture through the institutions it has chartered. These challenges are often shaped and influenced by events that are outside the control of the agency. Second, but no less important, are those challenges related to the agency’s operations. These management challenges were incorporated in the previous semiannual report but have been updated to reflect changes and progress in meeting the challenges.

### **Farm Credit System Risk**

The Farm Credit System (FCS) is a single industry lender and therefore is vulnerable to economic swings. The FCA is challenged to balance the often-competing demands of ensuring the FCS fulfills its public purpose, proactively examining risk in the regulated institutions both individually and systemically, and controlling the cost of the regulator.

### **Organizational Leadership**

The Farm Credit Act provides for a full time three-member Board. The Board members are appointed by the President and confirmed by the Senate. The rapidly changing, complex financial and banking environment makes the Board’s task both challenging and important. The Board must be able to engage in professional policy debate and set a sound course for the agency.

The Board is in an important period of transition. On August 6, 2002, the Board returned to full strength ending a 19-month period with only two Board members. The return to a full strength Board is an important element in setting clear priorities and deliberating fully on the issues.

A relatively small full-time Board also presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the agency. As

the membership on the Board changes, it needs to update its rules of operation to ensure it fulfills its statutory role in the governance of FCA.

## **Strategic Planning**

The FCA Strategic Plan was updated and revised for FY 2000 to reflect the FCA Board's priorities at that time. The current FCA Strategic Plan reflects an environment that has changed significantly since it was adopted – the composition of the Board, the economy, the structure of the FCS, and the President's Management Agenda. The FCA Board is getting input from a cross section of stakeholders and taking a fresh look at the substance of FCA's mission, goals and objectives. The Board will have the opportunity to set a course for FCA that focuses on the results that it wants to achieve through clear and balanced performance measures. The change in the Board's composition will allow the new Board to develop a new perspective that is not unduly constrained by past practices but builds on the experience of prior FCA Boards.

## **Human Capital**

The President identified human capital as a critically needed management reform in the Federal government. FCA needs to develop a comprehensive, integrated approach to human capital issues. In light of the changes in the competitive environment, advances in technology, and the tenure of its workforce; the agency will be challenged to closely evaluate business processes, their associated costs, and alternatives available through competitive sourcing. The General Accounting Office's (GAO) *High-Risk*<sup>1</sup> report outlined four pervasive human capital challenges that the government faces:

- Planning strategic human capital and organizational alignment;
- Planning for succession and leadership continuity;
- Acquiring and developing staffs whose size, skills, and deployment meet agency needs; and
- Creating results-oriented performance cultures.

## **Financial Management**

During FY 2001, FCA successfully implemented a financial management system using the services of the Department of Interior's National Business Center. FCA has received an unqualified audit opinion on its financial statements. However, financial management success goes beyond an unqualified financial statement audit opinion. Management's challenge is to leverage the system to deliver timely financial information that is critical for making well-informed management decisions. Meeting this challenge requires new measures of success. Measures such as delivering financial information that managers can use for day-to-day operations; and developing reports that capture the full cost of programs and projects can help bring about a transition.

## **Security**

In the recent report on information security, the OIG found a strong foundation for security practices. However, the speed of change in the security environment will be a challenge

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<sup>1</sup> GAO-01-263

for all government organizations. This is especially true for smaller organizations like FCA where an increased emphasis on physical and information security will compete with program areas for tight budget funding. Therefore, security remains a major challenge for the agency. The Continuity of Operations Plan needs to be updated and practiced. OIG has provided suggestions to management to facilitate an expedited effort in this regard.

### **Leveraging Technology**

The agency has recognized that in order to meet the constraints of its budget, it must be able to maximize its return on investment in technology. FCA will need effective mechanisms to ensure that current and future staff has the technical skills to use technology to operate in an efficient manner.

## **AUDIT AND INSPECTION REPORTS ISSUED**

We conduct all audits in accordance with the standards established by the Comptroller General of the United States for audits of Federal organizations, programs, activities, and functions. Inspections are in accordance with the President's Council on Integrity and Efficiency's Quality Standards for Inspections. Copies of most OIG reports are available on FCA's Web site ([www.fca.gov/oig](http://www.fca.gov/oig)), by contacting the OIG on 703/883-4030, or by e-mail at [IG\\_information@fca.gov](mailto:IG_information@fca.gov).

### **Independent Financial Audit**

In January 2003, the OIG transmitted Harper, Rains, Stokes & Knights, PA (HRSK) reports on the audit of the FCA's financial statements for the fiscal year ended September 30, 2002. HRSK issued an unqualified opinion. HRSK opined the financial statements present fairly, in all material respects, the financial position of FCA as of September 30, 2002 and 2001, in conformity with generally accepted accounting principles. HRSK issued two other reports. The report on the internal control noted no matters that HRSK considered to be material weaknesses. The HRSK report on compliance with laws and regulations did not note any instances of noncompliance. In addition to the three reports, a management letter was issued.

## **STATUS OF UNIMPLEMENTED AGREED UPON ACTIONS**

At the beginning of the period there were 10 unimplemented agreed upon actions. During the reporting period, management took final action on 5 of these. During this period, no agreed upon actions or recommendations were issued. At the end of this reporting period, 5 agreed upon actions remain open.

**Audits**

The following table summarizes the final actions management took on open agreed upon actions.

<b>AUDIT AGREED UPON ACTIONS</b>			
<b>Audit Report</b>	<b>Open during this 6-month period</b>	<b>Final Management Actions during this period</b>	<b>Open on 4/01/2003</b>
Performance Budgeting .....Issued March 23, 2001	4	1	3
Office of the Chief Financial Officer .....Issued January 24, 2002	3	1	2
FCA Contracting Activity .....Issued August 27, 2002	2	2	0
<b>Totals</b>	<b>9</b>	<b>4</b>	<b>5</b>

The audit report of Performance Budgeting was issued more than 24 months ago. Three of the original 14 agreed upon actions remain open. Once the agency takes actions on the remaining agreed upon actions, FCA should be capable of continuously monitoring its performance achievement against the related costs.

The OIG issued the audit report on the Office of the Chief Financial Officer more than 12 months ago. The two remaining agreed upon actions address the role of the Chief Financial Officer and the staffing of the organization.

**Inspections**

The following table summarizes the final action management took on an open agreed upon action.

<b>INSPECTION AGREED UPON ACTIONS</b>			
<b>Inspection Report</b>	<b>Open during this 6-month Period</b>	<b>Final Management Actions during this period</b>	<b>Open on 04/01/2003</b>
Purchase Card Program .....Issued September 9, 2002	1	1	0
<b>Totals</b>	<b>1</b>	<b>1</b>	<b>0</b>

Management took prompt action and closed the one remaining agreed upon action on the Purchase Card Program Inspection.

## **Investigations**

Most OIG Hotline calls and emails dealt with FCS borrower complaints and were referred to the FCA office responsible for reviewing such matters. All other Hotline calls and emails did not require investigative work by this office and were referred to the appropriate FCA office or other Federal agency.

Three investigations were open at the beginning of this reporting period. These investigations substantiated allegations of misuse of government purchase cards and travel cards and were closed when management took administrative action. Two new investigations were opened this period, with one being closed unsubstantiated.

## **Legislation And Regulations**

OIG staff reviewed several FCA regulations in both proposed and final form. Statutory and regulatory compliance issues were reviewed as they arose in the evaluative process. Also, we reviewed and commented on proposed legislation affecting the Inspectors General community through the legislation committee of the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency (PCIE/ECIE).

The Accountability of Tax Dollars Act of 2002, Pub. L. 107-289 (Nov. 7, 2002) requires annual financial statements for agencies, unless exempted by OMB. FCA has had an annual financial statement audit since the early 1990's so this will not impose anything new.

This reporting period we reviewed the Draft Super Circular distributed for comments by the Office of Management and Budget. Comments were submitted. We also reviewed several legislative proposals being considered as a revision to the Inspector General Act.

## **Other Activities**

### **Management Advisories**

During this reporting period, the OIG has continued the use of management advisories. These advisories provide management with feedback on issues that came to our attention during the process of performing other OIG work. In this 6-month period, we advised agency managers on issues including billings for reimbursable activities, credit card issuance and monitoring processes, travel policies, security practices, continuity of operations planning, and agency outreach activities.

### **Farm Credit System Insurance Corporation**

The Farm Credit System Insurance Corporation (FCSIC or Corporation) has assets exceeding \$1.7 billion. The mission of FCSIC is closely tied to the mission of FCA. The Farm Credit Act (12 USC 2277a-8) recognizes the interrelationship between FCA and FCSIC by establishing a common board structure. The Farm Credit Act also states "To the extent practicable, the Corporation shall use the personnel and resources of the Farm Credit Administration to minimize duplication of effort and to reduce costs."

The Inspector General advised the FCSIC Board that there is no explicit authority providing the FCA Inspector General the authority to examine FCSIC activities without

FCSIC's permission. However, the legislative history of the Inspector General Act indicates that Federal entities, such as FCSIC, may obtain the needed level of internal audit from an appropriate authority such as an existing OIG. The Inspector General continues to believe it is in the FCSIC Board's best interest to have an appropriate level of independent audit oversight that the OIG can provide.

### **Survey of Farm Credit System Institutions**

OIG administers an ongoing agency survey of the regulated institutions of the FCS. This survey is designed to provide the FCA Board and senior management with independent feedback about how well FCA performs its examination and enforcement activities. The feedback is based on confidential responses received from FCS institutions. We surveyed the Chairman of the Board and the Chief Executive Officer of each FCS institution, following their receipt of FCA's report of examination, for their voluntary feedback on the quality and consistency of the examination and enforcement processes. OIG reports the results of the survey annually. During this 6-month period we mailed 56 surveys and received 26 responses, equating to a 46 percent response rate. Overall, the average rating for the questions answered during this reporting period was slightly less favorable (1.7) [1=completely agree; 5=completely disagree] than the prior semiannual reporting period (1.66).

### **OIG Performance Measures**

OIG's performance measures were developed in 1995. Each year we review these measures and issue a report on our performance. It is available on the FCA OIG Web page at [www.fca.gov/oig](http://www.fca.gov/oig).

### **Staff Participation in Activities of the Professional Community**

OIG staff members are encouraged to take part in organizations that contribute to the mission of the Inspector General community, as well as their individual professional development. Most staff is actively involved in one or more professional organizations as well as ad hoc activities of the PCIE/ECIE.

### **Staff Participation in Agency Organizations**

Staff is active on several agency workgroups and task forces. During this reporting period the OIG was represented in Blacks in Government, FCA Employees' Council, Administrative Burden Reduction Workgroup, the Federal Women's Program, the Budget and Planning task force, the Employee Pay Workgroup and the Farm Credit Club.

### **Peer Review**

OIG staff conducted a peer review of the National Labor Relations Board, Office of Inspector General.

**AUDIT / INSPECTION REPORTS ISSUED BY FCA OIG**

TITLE OF REPORT	NUMBER OF RECOMMENDATIONS/ AGREED UPON ACTIONS	QUESTIONED COSTS	RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE
FCA Financial Statement	0	0	0
<b>Total</b>	<b>0</b>	<b>\$ 0</b>	<b>\$ 0</b>

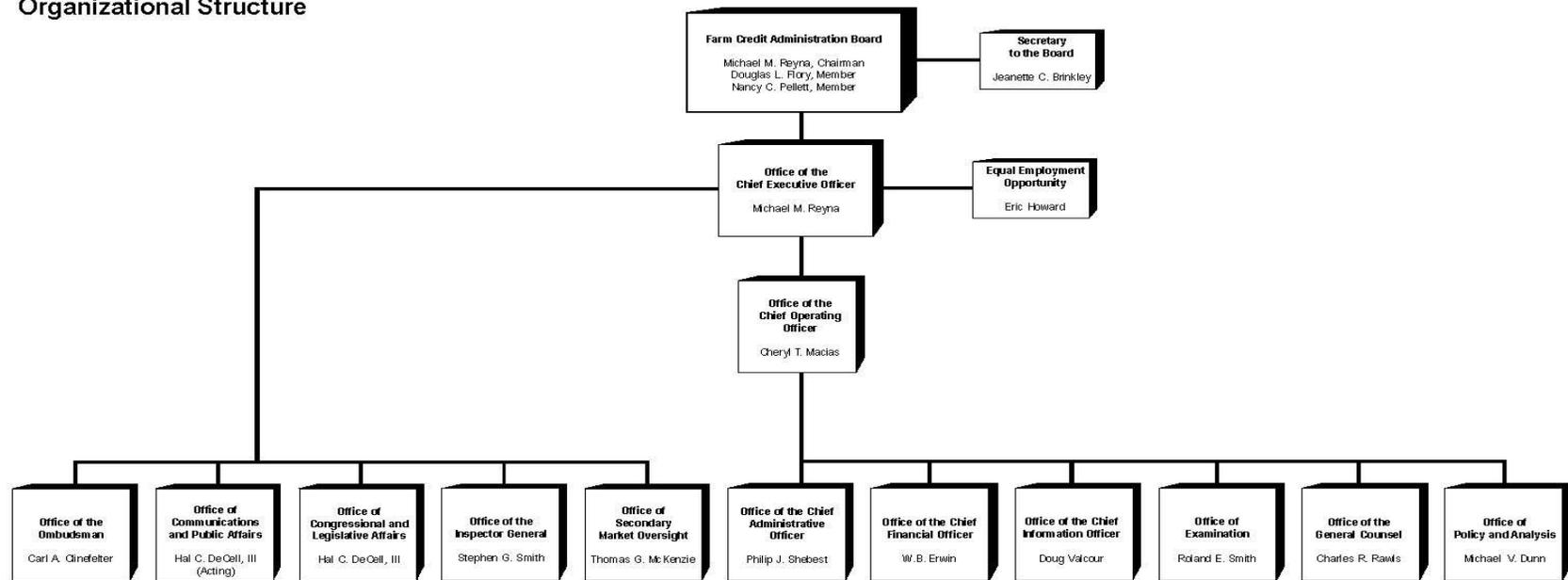
**INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS**

	Number		Dollar Value	
	Reports	Recs.	Questioned Costs	Unsupported Costs
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0	\$ 0
Subtotals (A+B)	0	0	\$ 0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0	\$ 0
(i) dollar value of disallowed costs	0	0	\$ 0	\$ 0
(ii) dollar value of costs not disallowed	0	0	\$ 0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0	\$ 0

**INSPECTOR GENERAL ISSUED REPORTS WITH  
RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE**

	Number		Dollar Value
	Reports	Recs.	
A. For which no management decision has been made by the commencement of the reporting period	0	0	\$ 0
B. Which were issued during the reporting period	0	0	\$ 0
Subtotals (A + B)	0	0	\$ 0
C. For which a management decision was made during the reporting period	0	0	\$ 0
(i) dollar value of recommendations that were agreed to by management	0	0	\$ 0
--based on proposed management action	0	0	\$ 0
-- based on proposed legislative action	0	0	\$ 0
(ii) dollar value of recommendations that were not agreed to by management	0	0	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	0	\$ 0
E. For which no management decision was made within six months of issuance	0	0	\$ 0

Farm Credit Administration  
 Organizational Structure



# Farm Credit Administration Office of Inspector General

